INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and regulations involved	2
Statement	2
Specification of errors to be urged	5
Summary of argument	6
Argument:	
I. The amendmentatory provisions to Section 302 (c) of the Revenue Act of 1926 are valid as applied to the trust created in 1932	9
II. There is nothing in the connection between the 1932 trust and the abortive instrument of 1927 that could defeat the tax	27
Conclusion	33
Appendix	34

CITATIONS

Cases:	
American Express Co. v. *Caldwell*, 244 U. S. 617	23
Atl. & Pac. Tea Co. v. *Grosjean*, 301 U. S. 412	11
Bank of Commerce v. *Tennessee*, 161 U. S. 134	31
Billings v. *Illinois*, 188 U. S. 97	11
Braden Steel Corp. v. *Commissioner*, 78 F. (2d) 808	32
Bromley v. *McCaughn*, 280 U. S. 124	10
Burnet v. *Northern Trust Co.*, 283 U. S. 782	16
Burnet v. *Wells*, 289 U. S. 670	11, 13
Carbon Steel Co. v. *Lewellyn*, 251 U. S. 501	32
Chase Nat. Bank v. *United States*, 278 U. S. 327	22
Chicago Board of Trade v. *Olsen*, 262 U. S. 1	23
Coolidge v. *Long*, 282 U. S. 582	24
Corliss v. *Bowers*, 281 U. S. 376	13
Crooks v. *Harrelson*, 282 U. S. 55	30
Doe, Lessee of Poor v. *Considine*, 6 Wall, 458	26
Edwards v. *Slocum*, 264 U. S. 61	19
Everard's Breweries v. *Day*, 265 U. S. 545	23
Guaranty Trust Co. v. *Blodgett*, 287 U. S. 509	24
Hale v. *Bowler*, 215 Mass. 354	29
Hale v. *Iowa State Board*, No. 16, 1937 Term, decided November 8, 1937	31
Harding v. *Harding*, 198 U. S. 317	28
Hassett v. *Welch*, No. 375, 1937 Term	9, 15, 31

32767—37——1

Cases—Continued.

	Page
Heiner v. *Colonial Trust Co.*, 275 U. S. 232	31
Helvering v. *City Bank Co.*, 296 U. S. 85	7, 20, 24
Keeney, Matter of, 194 N. Y. 281, affirmed, 222 U. S. 525	11, 15, 24
La Belle Iron Works v. *United States*, 256 U. S. 377	11
Lambert v. *Yellowley*, 272 U. S. 581	23
Latty v. *Commissioner*, 62 F. (2d) 952	30
Magnano Co. v. *Hamilton*, 292 U. S. 40	11
May v. *Heiner*, 281 U. S. 238	16
McCormick v. *Burnet*, 283 U. S. 784	16
McGowan v. *Parish*, 237 U. S. 285	29
Milliken v. *United States*, 283 U. S. 15	7, 10, 12, 21
Millsaps College v. *Jackson*, 275 U. S. 129	31
Morsman v. *Burnet*, 283 U. S. 783	16
Muller v. *Oregon*, 208 U. S. 412	19
Nashville &c., Railway Co. v. *United States*, 113 U. S. 261	29
New York Trust Co. v. *Eisner*, 256 U. S. 345	10
Nicol v. *Ames*, 173 U. S. 509	11
Pacific Co. v. *Johnson*, 285 U. S. 480	31
Porter v. *Commissioner*, 60 F. (2d) 673, affirmed, 288 U. S. 436	12, 22, 30
Purity Extract Co. v. *Lynch*, 226 U. S. 192	23
Quong Wing v. *Kirkendall*, 223 U. S. 59	11
Re Denne [1927] 2 Dom. L. Rep. 717	18
Reinecke v. *Northern Trust Co.*, 278 U. S. 339	12
Ruppert, Jacob v. *Caffey*, 251 U. S. 264	23
Saltonstall v. *Saltonstall*, 276 U. S. 260	12
Southern Ry. Co. v. *United States*, 222 U. S. 20	23
Stafford v. *Wallace*, 258 U. S. 495	23
Stebbins v. *Riley*, 268 U. S. 137	19
Chas. C. Steward Machine Co. v. *Davis*, 301 U. S. 548	11
Swift & Co. v. *United States*, 276 U. S. 311	29
Taft v. *Bowers*, 278 U. S. 470	22
Tyler v. *United States*, 281 U. S. 497	21
United States v. *Babbitt*, 104 U. S. 767	29
United States v. *Wells*, 283 U. S. 102	12
Welch v. *Helvering*, 290 U. S. 111	30
Westfall v. *United States*, 274 U. S. 256	23
Y. M. C. A. v *Davis*, 264 U. S. 47	19
Statutes:	
Finance Act of 1894, 57 & 58 Vict., c. 30, Sec. 2 (3)	18
Finance Act of 1900, 63 & 64 Vict., c. 7, Part III, Sec. 11 (1)	18
Joint Resolution of March 3, 1931, c. 454, 46 Stat. 1516 (U. S. C., Title 26, Sec. 411 (c))	34
Pennsylvania, Laws 1826, c. 72, Sec. 1	15
Revenue Act of 1916, c. 463, 39 Stat. 756, Sec. 202	15
Revenue Act of 1918, c. 18, 40 Stat. 1057	16
Revenue Act of 1921, c. 136, 42 Stat. 227	16

Statutes—Continued.	Page
Revenue Act of 1924, c. 234, 43 Stat. 253	16
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 302 (U. S. C., Title 26, Sec. 411)	34, 35
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 803 (U. S. C., Title 26, Sec. 411)	35
Succession Duty Act of 1853, 16 & 17 Vict., c. 51, Secs. 6, 7, 8	18
Miscellaneous:	
Cong. Rec., Vol. 74, Part 7:	
p. 7078	18
p. 7079	18
p. 7198	17
Regulations 37 (1919 Ed.), Art. 24	39
Regulations 37 (1921 Ed.), Art. 24	38
Regulations 63 (1922), Art. 20	38
Regulations 68 (1924), Art. 18	37
Regulations 70 (1926 Ed.), Art. 18	37
Regulations 70 (1929 Ed.), Art. 18	37
Regulations 80, Art. 18	36

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 349

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SELLAR BULLARD, AS EXECUTOR UNDER THE LAST WILL AND TESTAMENT OF CLARA R. SMITH, DECEASED

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 134–148) is reported in 34 B. T. A. 243. The opinion of the Circuit Court of Appeals (R. 165–172) is reported in 90 F. (2d) 144.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 25, 1937. (R. 172.) The petition for a writ of certiorari was filed August 25,

1937, and granted October 11, 1937. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The decedent executed an irrevocable trust in 1932, reserving a life estate to herself. The question presented is whether the Joint Resolution of March 3, 1931, and Section 803 (a) of the Revenue Act of 1932 may constitutionally be applied to impose an estate tax with respect to a trust created after the enactment of the 1931 Resolution.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra,* pp. 34–39.

STATEMENT

The facts, which were found by the Board of Tax Appeals and appear in its opinion, are as follows:

In 1927, the decedent had three living children, one son and two daughters, all of whom were married. (R. 135.) Her son, Edward A. Smith, acted as her business manager. She relied upon his judgment, suggestions, and advice. (R. 137.)

On March 3, 1927, she attempted to establish a trust, by which she transferred to her son various securities as trustee. The instrument provided that the income should be paid to the settlor during her life, and directed the trustee, upon her death, to separate the corpus into three separate

trusts, one for each of her children. The income from the trust for her son was to be paid to him for life, thereafter to his widow for life, unless a child survived him, in which case other disposition was to be made of the income and corpus. The separate trusts for each of the daughters provided for the distribution of income to them for life, and thereafter the income and corpus were to be distributed in a specified manner to their children or descendants. (R. 136.)

Edward died without issue on December 16, 1928, leaving a widow, Virginia Winslow Smith. (R. 17, 137.) In 1931 the decedent became dissatisfied with the trust created in 1927, by reason of the proposed investment policy of the successor trustee. She learned then that the trust was irrevocable, contrary to the representations made to her by her son in 1927, when it was executed. (R. 20, 137.) A bill in equity was prepared to declare the trust void on the ground of misrepresentation and fraud in the inducement. (R. 21, 116–134, 138.) In order to avoid family scandal, however, she was persuaded not to go through with the proceeding. (R. 138.)

Upon further examination of the instrument, it was discovered that the trust, in one respect at least, violated the rule against perpetuities. Accordingly, a bill in equity was prepared and filed in the Superior Court of Cook County, Illinois, on November 25, 1931, to declare the trust void. (R. 50–64, 138.) In answer to the bill, Virginia Wins-

low Smith denied that the trust was invalid (R. 87–89), but later consented to the entry of the desired decree, upon condition that a new trust would be executed, giving her the same rights which were purported to have been given her in the 1927 instrument (R. 138). The decree of the Illinois court was accordingly entered in 1932 (R. 25, 98–107), declaring that the trust was "wholly inoperative, void, and of no effect", and that all the assets held by the trustee were the decedent's "own, absolute property, free and clear from any trust declared in said trust agreement and free and clear of any right, claim, or demand of the defendants" (R. 106).

Of the assets thus returned to the decedent, about two-thirds never became the subject of any other *inter vivos* trust. On February 17, 1932, the decedent created a trust out of the remaining one-third, directing the trustee to pay the income to the decedent for life, and upon her death the income to Virginia Winslow Smith for life, and upon the latter's death to pay over the corpus to the two daughters of the decedent in equal shares. (R. 144.)

Upon the decedent's death in 1933, the Commissioner determined that the corpus of the 1932 trust should be included in her gross estate, in accordance with the provisions of Section 302 (c) of the Revenue Act of 1926, which had been recently twice amended (March 3, 1931, and June 6, 1932) to cover

specifically the case of a transfer with the reservation of a life estate to the transferor. This determination of the Commissioner was approved by the Board of Tax Appeals. (R. 134–148.) Upon appeal, the Circuit Court of Appeals agreed with the Government that the 1932 trust "must rest upon its own ground" (R. 168), and that it is for the purpose of this case wholly independent of the 1927 trust. But it nevertheless decided that the tax could not be imposed with respect to the 1932 trust, since it was "an irrevocable completed inter vivos gift" made before the decedent's death. (R. 170.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that Section 302 (c) of the Revenue Act of 1926, as amended by Joint Resolution approved March 3, 1931 (Public No. 131), and by Section 803 (a) of the Revenue Act of 1932, is contrary to and in violation of the Fifth Amendment to the Constitution of the United States.

2. In failing to hold that the corpus of the trust of February 17, 1932, is subject to Federal estate tax under Section 302 (c) of the Revenue Act of 1926, as amended by Joint Resolution approved March 3, 1931 (Public No. 131), and as further amended by Section 803 (a) of the Revenue Act of 1932.

3. In holding that the value of property transferred under an irrevocable deed of trust, under the

provisions of which the income from the property conveyed is reserved to the settlor for life, is not subject to the Federal estate tax under Section 302 (c) of the Revenue Act of 1926, as amended.

4. In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I

The first Federal estate tax law was enacted in 1916. It required, *inter alia*, the inclusion in a decedent's gross estate of transfers "intended to take effect in possession or enjoyment at or after * * * death". That clause had appeared in the laws of at least forty States, going back, in the case of Pennsylvania, as far as 1826. Moreover, it had been uniformly construed by the courts of those States as including a transfer which reserved a life estate to the decedent. Such a transfer had been long regarded as a substitute for a testamentary transfer and had often been resorted to in attempts to defeat death taxes. The Treasury Department had similarly construed the Federal statute and the clause had been reenacted four times in the light of that administrative practice. However, on March 2, 1931, this Court in three cases construed the Federal legislation as not including transfers which reserved a life estate to the transferor. On March 3, 1931, Congress, upon the anxious suggestion of the Treasury Department, in order to pre-

vent tax avoidance, enacted the Joint Resolution amending Section 302 (c) of the Revenue Act of 1926 specifically to include such transfers. It is pursuant to that amendment (as further amended in 1932) that the present tax is being asserted.

The prompt enactment of the Joint Resolution, the statements made to the Senate and the House by the Chairmen of the Finance and Ways and Means Committees respectively, the letter from the Acting Secretary of the Treasury which was read to the House—all these show that the March 3, 1931, amendment was based upon a clear recognition of the importance of such a provision to the successful maintenance of the estate tax system. Accordingly, since it is entirely appropriate for Congress to classify with property actually passing at death, certain *inter vivos* transfers that may have been made as substitutes for testamentary dispositions or made in order to defeat the estate tax (*Helvering* v. *City Bank Co.*, 296 U. S. 85; *Milliken* v. *United States*, 283 U. S. 15), we submit that the statute assailed here is a valid exercise of legislative power.

II

The tax here is being asserted with respect to the trust executed in 1932. The Circuit Court of Appeals ruled, and in this respect we support its decision, that the 1932 trust "must rest upon its own ground", independent of the 1927 instrument.

First, the 1927 trust was held by an Illinois court

of competent jurisdiction to be "wholly inoperative, void, and of no effect", and the assets held by the trustee thereunder were declared to be the decedent's "own absolute property, free and clear from any trust". Although that decree had been entered pursuant to the consent of the parties, it was nevertheless correct and binding upon them. Therefore, the corpus of the 1932 trust never had been subject to the provisions of the attempted trust of 1927, and any contention based upon the relationship between the two instruments must fail.

Second, even if the invalidity of the 1927 trust were open to dispute, the relinquishment of any claim thereunder was not sufficient to exempt the 1932 trust from the operation of Section 302 (c) as a "bona fide sale for an adequate and full consideration in money or money's worth". Not only was the transaction not a "sale" as that word is commonly understood, but there certainly was not an "adequate *and full*" consideration, since the release of a disputed (and probably invalid) claim to certain property interests in exchange for undisputed interests of the same magnitude is undoubtedly not *full* consideration. Moreover, the consideration was not "in money or money's worth". Finally, petitioner's position depends at most upon a series of doubtful constructions of the statute in his favor; but the rule is firmly settled that where an exemption from taxation is sought,

the statute must be construed most strongly against the one claiming it.

Third, even if the 1927 trust were entirely valid and even if the 1932 trust must be deemed to have derived its vitality from the 1927 trust, the tax is still proper. Had the decedent elected not to change the 1927 trust, it would have been included in her gross estate. See our brief in *Hassett* v. *Welch*, No. 375, present Term. Accordingly, the mere *substitution* of a new trust at a time when the earlier one was prospectively a part of the grantor's estate, is not based upon such consideration as comes within the exemption provision in Section 302 (c).

ARGUMENT

I

THE AMENDATORY PROVISIONS TO SECTION 302 (C) OF THE REVENUE ACT OF 1926 ARE VALID AS APPLIED TO THE TRUST CREATED IN 1932

Section 302 (c) of the Revenue Act of 1926, as amended by the Joint Resolution of March 3, 1931 (Appendix, *infra*, pp. 34–35), provides that there shall be included in the gross estate the value of any property of which the decedent has at any time made a transfer, by trust or otherwise, under which he has retained—

> for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property, or (2) the right to designate the persons who shall

possess or enjoy the property or income therefrom.

Section 302 (c) was further amended by Section 803 of the Revenue Act of 1932, but not in any respect material here.

In the instant case the decedent, in 1932, transferred in trust, certain property, but retained for her life the enjoyment of the income therefrom. Thus, the transfer comes within the precise language of the statute and should therefore be included in the gross estate, unless, as the court below held, the statute, as amended, is unconstitutional.[1]

1. There is no doubt of the power of Congress to impose estate taxes generally. *New York Trust Co.* v. *Eisner,* 256 U. S. 345. Nor is there any doubt that Congress may impose a tax upon *inter vivos* gifts. *Bromley* v. *McCaughn,* 280 U. S. 124. The only question then is whether, in imposing an estate tax, Congress may under specified circumstances require the inclusion of certain *inter vivos* transfers in the gross estate. This is merely a question of *classification* under the Fifth Amendment. See *Milliken* v. *United States,* 283 U. S. 15, 20.

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[1] In the court below, respondent took the position that the 1932 trust was not comprehended within the terms of the statute by reason of its relationship to the attempted trust of 1927. The court below rejected that argument, and we believe rightly so. However, in the event that respondent may ask to renew that contention in this Court, we consider it in detail in Point II, *infra,* pp. 27–33.

How broad the scope of a state's power to classify may be without running afoul of the Fourteenth Amendment, we need hardly discuss. Random examples are furnished by *Atl. & Pac. Tea Co.* v. *Grosjean,* 301 U. S. 412, *Keeney* v. *New York,* 222 U. S. 525, and *Billings* v. *Illinois,* 188 U. S. 97. The test is always whether the classification is so arbitrary, so capricious, so devoid of any reasonable basis that it must be declared invalid. Moreover, since the restraints upon a state's power under the Fourteenth Amendment rest not only upon the due process clause but also upon the equal protection clause, the latitude permissible to *Congress* under the Fifth Amendment, which contains no equal protection clause, is subject to limitations "less narrow and confining". See *Chas. C. Steward Machine Co.* v. *Davis,* 301 U. S. 548, 584; *LaBelle Iron Works* v. *United States,* 256 U. S. 377, 392; *Quong Wing* v. *Kirkendall,* 223 U. S. 59, 62. And the usually strong presumption in favor of the validity of an act of Congress is "particularly true of a revenue act of Congress". *Nicol* v. *Ames,* 173 U. S. 509, 515. Compare *Burnet* v. *Wells,* 289 U. S. 670, 677–678; *Magnano Co.* v. *Hamilton,* 292 U. S. 40, 44.

2. We submit that in this case there is a valid basis for the classification, namely, that a transfer which reserves to the transferor the possession or enjoyment during his life, i. e., a life estate, operates as a reasonable substitute for a testamentary

transfer, and as such may properly be classified with transfers of property vesting in interest at death.

The Federal estate tax seeks to reach not only property passing at death, but also transfers intended as substitutes for testamentary dispositions. Probably, the most familiar of these is the gift in contemplation of death. It is included in the gross estate even though it be irrevocable, and even though it may have been made and completed many years before the donor's death. Although "nothing passes at death", the transfer is taxed as a part of the gross estate, because it is a *reasonable substitute for a testamentary disposition,* and as such may properly be classified with property actually passing at death. See *Milliken* v. *United States,* 283 U. S. 15, 20; *United States* v. *Wells,* 283 U. S. 102. The due process clause of the Fifth Amendment is not offended by such a classification, since the *inter vivos* transfer bears a reasonable relationship to death transfers.

Similarly, an *inter vivos* transfer in which a power of revocation is reserved may be included in the measure of the donor's gross estate. *Reinecke* v. *Northern Trust Co.,* 278 U. S. 339. Cf. *Porter* v. *Commissioner,* 288 U. S. 436; *Saltonstall* v. *Saltonstall,* 276 U. S. 260. The reservation of such control and the termination thereof at the settlor's death is the element that transforms an otherwise non-testamentary transfer into one that has a def-

inite relationship to gifts at death. But the reservation of such control *is not the only element* that may justify the tax. For as we have seen, an irrevocable gift, if made in contemplation of death, may likewise be included in the decedent's gross estate. The important thing is this: Both are testamentary in character, one is testamentary because of the reserved power, the other by reason of the inherent nature of the gift.

Accordingly, Congress may require the inclusion of an *inter vivos* transfer in the donor's gross estate if it bears any reasonable relationship to a testamentary disposition; and that relationship may exist *either* because there are reserved powers in the donor which terminate at his death, *or* because the gift has other characteristics that justify its being considered a substitute for a testamentary disposition.[2]

The pivotal question, therefore, is whether there is anything about the disputed transfer that renders it an appropriate substitute for a testamentary transfer. And it is the Government's position that where the decedent has reserved a life estate, the transfer partakes sufficiently of a testamentary

[2] A similar situation exists in the field of income taxation. In addition to taxing income to the one who receives it, Congress may tax (a) the grantor of a revocable trust (*Corliss* v. *Bowers*, 281 U. S. 376) because of his power to control the income; or (b) it may tax the grantor of an irrevocable trust, if under appropriate circumstances the trust performs a function for him that might normally be performed by the use of his own income (*Burnet* v. *Wells*, 289 U. S. 670).

disposition to justify the classification. By retaining the *enjoyment* of the property until the date of her death, the decedent could reasonably feel that she was making, through the trust, a disposition of property that she might otherwise accomplish by will.[3]

3. The events leading up to the enactment of the Joint Resolution of March 3, 1931, which specifically imposes a tax upon a transfer such as the trust involved herein, are of the utmost significance in disclosing the basis for the classification of such trusts along with other transfers of a testamentary nature. Those events show plainly that Congress understood this type of transfer as being particu-

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[3] The very facts of this case fortify this conclusion. The corpus of the 1932 trust came from the attempted trust of 1927. The 1927 instrument divided the property into three parts. The 1932 trust dealt only with one of those parts, the other two-thirds being retained by the decedent, and the provisions in respect to the two-thirds were roughly incorporated in a will which the decedent executed about the same time as the creation of the 1932 trust. (R. 72–78, paragraphs "Sixth" and "Seventh".) She would have liked to treat the remaining one-third similarly by will, but in view of the opposition of her daughter-in-law, she was compelled to achieve the same result through the trust device. Surely this was intended, and reasonably so, as a substitute for a testamentary disposition.

The 1932 trust also reserved to the decedent during her lifetime, but only after the death of her daughter-in-law, the right to alter, change or amend the trust and to withdraw all or any portion of the corpus. (R. 143.) While we are not making any independent argument based upon this reserved right, it nevertheless fortifies the characterization of the trust as a substitute for a testamentary disposition.

larly suitable as a substitute for a testamentary transfer, and that the provisions were enacted in order to stop tax avoidance.

This background is set forth in detail in our brief in *Hassett* v. *Welch*, No. 375, present Term, pp. 19–28. The history there recounted shows that the first Federal estate tax law, which was enacted in 1916, undertook to tax as part of a decedent's estate not only transfers made "in contemplation of" death, but also transfers "intended to take effect in possession or enjoyment at or after" death. Section 202 (b) of the Revenue Act of 1916, c. 463, 39 Stat. 756. The latter clause was not novel. It appeared in substantially the same form ninety years before in the death tax statute of Pennsylvania, Laws 1826, c. 72, Sec. 1. When the Federal estate tax was first imposed in 1916, that clause had been incorporated into the death tax laws of at least forty States. And such state courts as were called upon to deal with that clause both before and after the enactment of the 1916 Act, have, in an almost overwhelming number of cases, treated it as including a transfer in which the decedent had retained a life estate. Indeed, such a transfer was regarded as the leading type of gift "intended to take effect in possession or enjoyment at or after death." As the Court of Appeals of New York said in *Matter of Keeney*, 194 N. Y. 281, 287 (affirmed, 222 U. S. 525):

> It is true that an ingenious mind may devise other means of avoiding an inheritance tax,

but the one commonly used is a transfer with reservation of a life estate. (Italics supplied.)

The Treasury Department repeatedly gave the Federal statute the same construction, and in the light of those interpretations Congress reenacted that clause in the Revenue Acts of 1918, c. 18, 40 Stat. 1057; 1921, c. 136, 42 Stat. 227; 1924, c. 234, 43 Stat. 253, and 1926, c. 27, 44 Stat. 9 (the last basic estate tax statute).

On March 2, 1931, however, this Court held in three cases that such transfers were not comprehended within the language of the statute. *Morsman* v. *Burnet,* 283 U. S. 783; *Burnet* v. *Northern Trust Co.,* 283 U. S. 782; *McCormick* v. *Burnet,* 283 U. S. 784.[4] In each of these cases a *per curiam* opinion was delivered, stating that the question was one solely of statutory construction, "there being no question of the constitutional authority of the Congress to impose prospectively a tax with respect to transfers or trusts of the sort here involved * * *". 283 U. S. at pp. 783, 784. On the day

[4] The decisions were on the authority of *May* v. *Heiner,* 281 U. S. 238. That case did not involve a retention of possession or enjoyment by the grantor, but rather gave an immediate life estate to a third person, with a life estate thereafter to the grantor, and then remainders over. Since in that case the grantor might never come into possession or enjoyment of the property before death, the Treasury Department had not, until those three decisions, regarded *May* v. *Heiner* as determinative of the question presented in those cases.

following these decisions Congress, upon the anxious suggestion of the Treasury Department, enacted the Joint Resolution here involved, amending Section 302 (c) of the Revenue Act of 1926 to include specifically transfers of the character here in question.

The prompt enactment of the Joint Resolution of March 3, 1931, was based upon a clear recognition of the importance of such a provision to the successful maintenance of the estate tax system. A letter from Ogden L. Mills, Acting Secretary of the Treasury, which was read in the House, stated (Cong. Rec., Vol. 74, Part 7, p. 7198): "Without this amendment, the Federal estate tax will be seriously affected. It has been estimated that the effect of these Supreme Court decisions will be to cause a loss in excess of one-third of the revenue derived from the Federal estate tax, with anticipated refunds in excess of $25,000,000." The letter urged enactment of the resolution "in view of the character of these transfers and in order to prevent tax evasion."

The Chairman of the House Committee on Ways and Means, Mr. Hawley, expressed similar concern (Cong. Rec., Vol. 74, Part 7, p. 7198):

> It had generally been considered that this provision of the statute covered cases such as those referred to above [*Morsman* v. *Burnet, supra; Burnet* v. *Northern Trust Co., supra; McCormick* v. *Burnet, supra*]. The Treasury Department had so construed

> the statute since the first Federal estate tax law in 1916 and its regulations so provide. * * *
>
> It is entirely apparent that if this situation is permitted to continue, the Federal estate tax will be seriously affected. * * * It is of the greatest importance therefore that this situation be corrected and *that this obvious opportunity for tax avoidance be removed.* It is for that purpose that the joint resolution is proposed. [Italics supplied.]

Like representations were made to the Senate by the Chairman of the Finance Committee, Senator Smoot. Cong. Rec., Vol. 74, Part 7, pp. 7078–7079.

Accordingly, it is clear that Congress understood these provisions as an integral part of a system of Federal death taxes. That this type of transfer might be resorted to in order to defeat the estate tax appeared from the precautionary steps to thwart such avoidance taken by the legislatures in the death tax statutes, not only in forty of our States,[5] but in Canada[6] and England[7] as well. The action of those legislatures is, we submit, additional cogent evidence as to the reasonableness of

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[5] See pp. 20–22, Government's brief in No. 375.

[6] See *Re Denne*, [1927] 2 Dom. L. Rep. 717.

[7] Cf. the Succession Duty Act of 1853, 16 & 17 Vict., c. 51, Secs. 6, 7, and 8; the Finance Act of 1894, 57 & 58 Vict., c. 30, Sec. 2 (3); the Finance Act of 1900, 63 & 64 Vict., c. 7, Part III, Sec. 11 (1).

the classification made by Congress.* Cf. *Muller* v. *Oregon*, 208 U. S. 412, 419–421.

4. Therefore, we submit that Congress was plainly justified in making the classification. It reasonably anticipated that such transfers might be made to avoid estate taxes, and it had ample power to prevent such avoidance. The principle that an Act of Congress may be valid as being reasonably necessary and proper to the exercise of the taxing power is not open to serious challenge.

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*The state statutes and decisions are not to be distinguished in this connection upon the ground that most of them involved legacy or succession taxes rather than estate taxes. It is true that the former impinge upon the "receiving" end of the transfer while the latter are imposed upon the "giving" end. And it is also true that many vital factors may depend upon which kind of death tax is being imposed, as, for example, where, as between different legatees, the burden of the tax is to fall. *Y. M. C. A.* v. *Davis*, 264 U. S. 47. Cf. *Edwards* v. *Slocum*, 264 U. S. 61; *Stebbins* v. *Riley*, 268 U. S. 137.

But the question whether a given *inter vivos* transfer is of such character that it might be made in substitution for a gift by will, is the same under both types of death tax. Thus the test of "contemplation of death" is substantially the same under both types, and such transfers may be taxed under either type of statute as transfers reasonably related to the basic tax in the statute. Similarly here, the test is whether the transfer involved is of such character as might reasonably be classified with transfers made at death. This inquiry is not advanced by considering whether anything "passes at death", but rather the true test is, as in the case of gifts made in contemplation of death, whether the transfer subserves to the transferor a purpose that he might normally accomplish through a will.

In *Helvering* v. *City Bank Co.*, 296 U. S. 85, this Court upheld the validity of Section 302 (d) of the Revenue Act of 1926, which provides for the inclusion in the gross estate of property which the decedent has transferred retaining the power, either alone or in conjunction with any person, to alter, amend, or revoke. It was contended in vain that the statute was arbitrary as applied to a transfer in which the consent to revoke must come from the transferee himself. The Court sustained the constitutionality of that provision on the ground that it was reasonably deemed necessary to prevent tax avoidance (p. 90):

> The respondent insists that a power to recall an absolute and complete gift only with the consent of the donee is in truth no power at all; that in such case the so-called exercise of the power is equivalent to a new gift from the donee to the donor. And so it is claimed that the statute arbitrarily declares that to exist which in fact and law is nonexistent. The position is untenable. The purpose of Congress in adding clause (d) to the section as it stood in an earlier act was *to prevent avoidance* of the tax by the device of joining with the grantor in the exercise of the power of revocation someone who he believed would comply with his wishes. Congress may well have thought that a beneficiary who was of the grantor's immediate family might be amenable to persuasion or be induced to consent to a revocation in consideration of other expected benefits from the grantor's

> estate. *Congress may adopt a measure reasonably calculated to prevent avoidance of a tax.* [Italics supplied.]

Again, in *Milliken* v. *United States,* 283 U. S. 15, the Court found at least partial support for the validity of the tax on gifts in contemplation of death in the fact that the measure was an appropriate adjunct to the estate tax law, saying (p. 24):

> Further, as an appropriate and indeed necessary measure to secure the effective administration of a system of death taxes, we think the present tax is to be supported as an incident and in aid of the exercise of the constitutional power to levy a tax on the transfer of the decedent's estate at death.

Similarly, in *Tyler* v. *United States,* 281 U. S. 497, the Court again relied upon the adjunct theory in upholding the inclusion in a decedent's gross estate of the *entire* value of property held by the entirety. The Court said (p. 505):

> The evident and legitimate aim of Congress was to prevent an avoidance, in whole or in part, of the estate tax by this method of disposition during the lifetime of the spouse who owned the property, or whose separate funds had been used to procure it; and the provision under review *is an adjunct of the general scheme of taxation* of which it is a part, entirely appropriate as a means to that end. [Italics supplied.]

In like manner, the Court upheld the inclusion in a decedent's gross estate of the proceeds of life in-

surance policies. *Chase Nat. Bank* v. *United States,* 278 U. S. 327. Although the insured had retained powers to surrender the policies for cash and to change the beneficiaries, it was clear that at the moment immediately preceding his death, the cash value of those policies was considerably less than aggregate face amount of the policies. Thus, even though it was plain that the *entire* amount taxed did not "pass from" the decedent at the time of death, yet by virtue of the close similarity of such life insurance to testamentary transfers, the tax was sustained.

Again, in *Porter* v. *Commissioner,* 288 U. S. 436, it was clear that while the grantor had reserved the power to modify the trust, nothing passed *from his estate* at the time of death, since he did not reserve the right to modify the trust in his own favor. The tax was nevertheless upheld. "The net estate upon the transfer of which the tax is imposed, is not limited to property that passes from decedent at death." *Id.,* p. 443.

In *Taft* v. *Bowers,* 278 U. S. 470, the Court sustained a provision requiring the donee of property to use the donor's cost (or other basis) in measuring the taxable gain from the subsequent sale of such property. Although it was there contended that the gain computed in that manner did not accurately reflect the donee's income, the provision was nevertheless upheld as being "entirely appropriate for enforcing a general scheme of lawful taxation" (p. 482).

The decisions of this Court outside the field of taxation likewise demonstrate that Congress may take reasonable steps to implement an exercise of Federal power. *Everard's Breweries* v. *Day*, 265 U. S. 545; *Lambert* v. *Yellowley*, 272 U. S. 581, 594; *Jacob Ruppert* v. *Caffey*, 251 U. S. 264; *Stafford* v. *Wallace*, 258 U. S. 495, 513; *Purity Extract Co.* v. *Lynch*, 226 U. S. 192; *Southern Ry. Co.* v. *United States*, 222 U. S. 20; *American Express Co.* v. *Caldwell*, 244 U. S. 617; *Chicago Board of Trade* v. *Olsen*, 262 U. S. 1; *Westfall* v. *United States*, 274 U. S. 256, 259.

5. We have endeavored to show that Congress was justified in assuming that a trust reserving a life estate to the grantor might be used as a substitute for a testamentary disposition, and that therefore, in order to prevent tax avoidance, it was further justified in requiring such transfers to be taxed as testamentary dispositions. We believe, therefore, that we have already established the validity of the challenged provisions.

The great and underlying fallacy of the contrary view is the contention that "something must pass at death" before the transfer can be taxed. It is true that where "something *does* pass at death", or where there is a shifting of economic interests at death (as in the case of an *inter vivos* transfer reserving a power of revocation), then that fact alone justifies the tax. But the converse is not true. For, there may be a tax even though no interest

passes at death, as in the case of a gift in contemplation of death, or as in the case of such a transfer as was involved in *Helvering* v. *City Bank Co.*, 296 U. S. 85. The important thing is whether, under all the circumstances, Congress could reasonably regard the transfer either as an actual testamentary disposition or as one that might be made as a substitute therefor.

Any doubt as to the application of these principles to the present situation must be dispelled by the decision of this Court in *Guaranty Trust Co.* v. *Blodgett*, 287 U. S. 509. There, an irrevocable trust reserving to the grantor a life interest was held constitutionally subject to the Connecticut death tax statute. It was assumed that the remainders were vested in interest at once upon the creation of the trust. But this Court approved the state court's "distinction between taking effect in possession or enjoyment and vesting in right, title or interest * * *" (p. 512), and held that the tax was not violative of the Fourteenth Amendment. A like result had been reached some years before in *Keeney* v. *New York*, 222 U. S. 525.* See also *Coolidge* v. *Long*, 282 U. S. 582, 596.

Respondent may perhaps contend that those cases have no bearing here since we are now dealing with an estate tax, whereas inheritance taxes were there involved. But, although there may be many

*In that case there was, in addition, a power to revoke upon six months' notice, but it did not appear to play any part in the Court's decision.

vital differences between these two types of death taxes (see footnote 8, *supra*, p. 19), they are both, nevertheless, *death* taxes. In the one the tax falls upon the *transmitting* end of the transfer, in the other upon the *receiving* end. In both, however, the transfer must be testamentary in character. Thus, gifts made in contemplation of death are taxed under both types of death taxes, and the question is not whether something has passed from the donor at time of death (in the case of estate taxes), nor whether something has been received at the donor's death by the recipient (in the case of inheritance taxes). The critical factor in both situtions is whether there has been a substitute for a testamentary gift. And a holding that a certain *inter vivos* transfer is sufficiently related to a transfer at death that a legislature may consistently with due process require it to be so classified, is a holding that applies to both types of death taxes.

6. Thus far we have contended that Congress may classify *inter vivos* transfers with gifts at death, if the *inter vivos* transfers have any reasonable relation to or may reasonably be considered as substitutes for testamentary dispositions; and that an *inter vivos* trust in which the settlor has reserved full possession or enjoyment until death is such an *inter vivos* transfer. It has thus been unnecessary to argue that property has "passed" at death. But we do not mean to imply or concede

that nothing has passed at death here. For, property which had previously been enjoyed by the settlor, is at her death for the first time enjoyable by the remainderman.

Although the remainderman's interest may become "vested" at once upon the creation of the trust, his enjoyment is postponed. "A vested remainder is where a *present* interest passes to *a certain and definite* person, but to be enjoyed *in futuro.*" *Doe, Lessee of Poor* v. *Considine,* 6 Wall. 458, 474.

The death of the settlor therefore does terminate the life interest and frees the property for the remainderman. There is in reality a factual transfer at death. What was formerly merely a right with respect to the property has ripened by virtue of the grantor's death into the full and complete enjoyment of the property itself. The remainder interest before death was something far less substantial than the property itself. Indeed, the amount for which the remainder could be sold in the market at the time the trust was created was probably considerably less than the value of the property itself. In a very real sense, therefore, the settlor's death has effected a "passing" of property and a shifting of enjoyment at that time. There has been a genuine enlargement of the remainderman's rights by the death of the life tenant. And we believe that Congress should be

able to impose a tax upon such a shifting of interests and rights at death.

However, it is not necessary for us to pitch our case upon this ground. Our primary position rests upon the broader contention that, even assuming that nothing has passed at death, this is the type of *inter vivos* transfer that may be classified with testamentary dispositions.

II

THERE IS NOTHING IN THE CONNECTION BETWEEN THE 1932 TRUST AND THE ABORTIVE INSTRUMENT OF 1927 THAT COULD DEFEAT THE TAX

The court below held that the 1927 trust plays no part in this controversy and that the 1932 trust "must rest upon its own ground." (R. 168.) With this we fully agree. However, in the event that respondent may renew his contentions that the relationship between the two instruments operates to relieve the estate of this tax liability, we now make the following anticipatory answers in support of that conclusion of the court below.

First. Respondent may contend that since decedent's daughter-in-law consented to the formal termination of the 1927 trust, such circumstances constitute a "bona fide sale for an adequate and full consideration in money or money's worth," and therefore the 1932 trust is not even within the purview of Section 302 (c).

However, the 1927 instrument was void, at least as to that third which formed the basis for the 1932 trust. For, with respect to the one-third allocable to decedent's son, the instrument attempted to create interests that might not vest within lives in being plus twenty-one years. The facts upon which this third of the 1927 trust violated the rule against perpetuities are fully set forth in the decree of the Illinois court at pages 101–103 of the record herein. Whether the invalidity of that one-third was sufficient to render the other two-thirds void also, is a nice question, but not important here, since the 1932 trust involved in this proceeding arises solely from that one-third of the 1927 trust that was clearly invalid.[10]

While it is true that the decree of the Illinois court was entered pursuant to the consent of the parties, that fact does not detract from its correctness. The invalidity of the one-third of the 1927 trust under the rule against perpetuities is patent. And furthermore, a consent decree may be as binding and conclusive as any other. See *Harding* v. *Harding*, 198 U. S. 317, where this Court said (p. 335):

> The general rule in Illinois undoubtedly is that a consent decree has the same force

[10] The Illinois court, however, declared that since under the circumstances decedent would not have created any part of the 1927 trust if she had known that the portion for her son would be invalid, the entire trust was void. (R. 102–103.)

and effect as a decree *in invitum*. *Knobloch* v. *Mueller*, 123 Illinois, 554; *O'Connell* v. *Chicago Terminal R. R.*, 184 Illinois, 308, 325.

Cf. *Swift & Co.* v. *United States*, 276 U. S. 311; *McGowan* v. *Parish*, 237 U. S. 285, 295; *Nashville, &c., Railway Co.* v. *United States*, 113 U. S. 261, 266; *United States* v. *Babbitt*, 104 U. S. 767.

Accordingly, as the decree of the Illinois court declared, the 1927 trust (or at least that one-third which formed the basis for the 1932 trust) was "wholly inoperative, void, and of no effect" and the assets held by the trustee were the decedent's "own absolute property, free and clear from any trust". (R. 106.) Therefore, the corpus of the 1932 trust never had been subject to the provisions of the attempted trust of 1927, and those designated as beneficiaries in the earlier instrument had no claim whatever against those assets. Under these circumstances, the contention that there was the requisite consideration for the 1932 trust to remove it from the scope of Section 302 (c) is, we submit, without foundation.[11] Cf. *Hale* v. *Bowler*, 215 Mass. 354.

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[11] The contention of respondent, made below, that those designated as beneficiaries under the 1927 trust, rather than the decedent, were the real settlors of the 1932 trust, is merely a different version of the point we have just discussed, and what we have said with respect thereto disposes of this contention as well.

Second. Even if the validity of the one-third of the 1927 trust were open to dispute, there still has not been a compliance with the exemption requirements of Section 302 (c). An exemption is given only where there is a "bona fide sale for an adequate and full consideration in money or money's worth".

Upon the assumption that there might have been a disputed claim against the 1927 trust, its relinquishment certainly was not a compliance with the exemption requirements. While it is true that a promise to give up a disputed claim may operate technically as a valid "consideration" under the law of contracts, what is called for here is far more than that.

Not only was the transaction not a "sale" as that term is ordinarily used, but the consideration required by the statute must be "adequate *and full*" [italics supplied]. This is stated in the conjunctive and must be so construed. Cf. *Crooks* v. *Harrelson,* 282 U. S. 55; *Welch* v. *Helvering,* 290 U. S. 111. The release of a disputed (and probably invalid) claim in exchange for an *undisputed* estate of the same magnitude can hardly be said to be "*full* consideration". And beyond all doubt, it certainly was not in "money or money's worth". Cf. *Porter* v. *Commissioner,* 60 F. (2d) 673 (C. C. A. 2d), affirmed as to another point, 288 U. S. 436; *Latty* v. *Commissioner,* 62 F. (2d) 952 (C. C. A. 6th).

Thus it appears that respondent's claim to an exemption from taxation here rests, at most, upon a series of highly dubious interpretations of nearly each word in the exemption clause. But the rule is well settled that an exemption is to be strictly construed against the one claiming it. What this Court said in *Bank of Commerce* v. *Tennessee,* 161 U. S. 134, is particularly pertinent here (p. 146):

> There must be no doubt or ambiguity in the language used upon which the claim to the exemption is founded. It has been said that a well founded doubt is fatal to the claim; * * *.

See also *Hale* v. *Iowa State Board,* No. 16, 1937 Term, decided November 8, 1937; *Pacific Co.* v. *Johnson,* 285 U. S. 480, 491; *Millsaps College* v. *Jackson,* 275 U. S. 129, 132; *Heiner* v. *Colonial Trust Co.,* 275 U. S. 232.

Third. But even if the 1927 trust had been wholly valid, and even though the interests created in the 1932 trust must be traced back to the earlier instrument, there has still been a failure to come within the exemption in Section 302 (c).

The 1927 trust itself had been created without any consideration. And in that trust decedent reserved the income to herself for life. Accordingly, had she permitted it to continue until her death, the corpus of that trust would have been included in her gross estate. See Government's brief in *Hassett* v. *Welch,* No. 375, present Term.

Respondent's contention would then come to this: That by relinquishing rights under an existing trust already includable in the settlor's gross estate on condition that the settlor execute a new trust embodying substantially the same provisions, the settlor and beneficiaries together without really giving up anything could defeat the operation of the estate tax. We submit that this is not only fantastic but, if sustained, would emasculate the provisions in Section 302 (c) requiring a tax on a transfer with a reserved life interest. It would be hardly more than a trifling matter for the settlor and beneficiaries to get together in any case and execute a new trust in identical or substantially identical terms as the old, merely upon condition that each relinquish his rights under the old. It seems clear, therefore, that Congress did not intend the exemption to apply under such circumstances. Cf. *Carbon Steel Co.* v. *Lewellyn*, 251 U. S. 501, 504; *Braden Steel Corp.* v. *Commissioner*, 78 F. (2d) 808, 810 (C. C. A. 10th).

The rule exempting a transfer of property when there has been adequate and full consideration is based upon the theory that the property, which would prospectively form a part of the decedent's estate, is being replaced by other property and therefore the total taxable estate is not being diminished by such a transfer. But if exemption were applied here it would diminish the gross estate of the decedent, since the earlier trust, at the

time of the execution of the 1932 trust, was includable in the decedent's gross estate in accordance with the amended provisions of Section 302 (c). Thus, we believe it impossible to attribute to Congress the intention to permit such an obvious device to avoid the incidence of a tax about which it has displayed such solicitude.

CONCLUSION

The judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

STANLEY REED,
Solicitor General.
JAMES W. MORRIS,
Assistant Attorney General.
SEWALL KEY,
ELLIS N. SLACK,
ARNOLD RAUM,
Special Assistants to the Attorney General.

DECEMBER, 1937.

APPENDIX

As originally enacted, Section 302 (c) of the Revenue Act of 1926, c. 27, 44 Stat. 9, provided:

> The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—
>
> * * * * *
>
> (c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. * * * (U. S. C., Title 26, Sec. 411.)

The Joint Resolution of March 3, 1931, c. 454, 46 Stat. 1516, amended subsection (c) to read as follows (the language in italics representing the new matter):

> (c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, *including a transfer under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property or (2) the right to designate the persons who shall possess or enjoy the property or the income therefrom;* ex-

cept in case of a bona fide sale for an adequate and full consideration in money or money's worth. (U. S. C., Title 26, Sec. 411 (c).)

Section 302 (c) was further amended by Section 803 of the Revenue Act of 1932, c. 209, 47 Stat. 169, to read as follows:

(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title. (U. S. C., Title 26, Sec. 411.)

Section 302 (h) of the Revenue Act of 1926, *supra*:

Except as otherwise specifically provided therein subdivisions (b), (c), (d), (e), (f),

and (g) of this section shall apply to the transfers, trusts, estates, interests, rights, powers, and relinquishment of powers, as severally enumerated and described therein, whether made, created, arising, existing, exercised, or relinquished before or after the enactment of this Act. (U. S. C., Title 26, Sec. 411.)

Regulations 80 (1934):

ART. 18. *Transfers with possession or enjoyment retained.*—(a) *Transfers included.*—The statutory phrase, "a transfer * * * intended to take effect in possession or enjoyment at or after his death", includes a transfer, whether in trust or otherwise, made subject to the reservation by the decedent of the use, or the possession, or the rents or other income of the transferred property, or any part thereof, for his life, or for a period ascertainable only by reference to his death, or for a period of such duration as to evidence his intention to retain the enjoyment (in whole or in part) of the transferred property throughout his life. (See article 15.)

(b) *Taxability.*—Every such transfer (not amounting to a bona fide sale for an adequate and full consideration in money or money's worth), made by the decedent subsequent to September 8, 1916, is taxable, and the value of the property or interest so transferred shall be included in the gross estate of the decedent. The provisions of this subdivision do not apply (1) if the transfer was made prior to 10:30 p. m., eastern standard time, March 3, 1931, and (2) if the decedent died prior to 5 p. m., eastern standard time, June 6, 1932. See section 506 of the Revenue Act of 1934.

Regulations 70 (1929 Edition):

ART. 18. *Reservation of income or an annuity.*—A transfer, not amounting to bona fide sale for an adequate and full consideration in money or money's worth, is taxable where the decedent reserved to himself during life the entire income of the property transferred. In such a case the transfer of the principal takes effect in possession and enjoyment at the death of the decedent, and the value of the entire property should be included in the gross estate.

Where the decedent reserved only a portion of the income, only a corresponding proportion of the value of the property should be included in the gross estate, unless, however, the possession or enjoyment of the remaining portion of the transferred property, or a part thereof, was postponed until at or after the decedent's death, in which case there should also be included in the gross estate such remaining portion or part thereof, as the case may be. Thus, for example, if the reservation was one-half of the income then one-half of the value of the transferred property should be included, and if, in addition to such reservation, it was intended by the decedent that possession or enjoyment of the remaining portion of the property should be postponed until at or after his death, then the value of the entire property should be included.

* * * * *

Article 18 of Regulations 70 (1926 Edition), and of Regulations 68 (1924) contains in substantially the same language the foregoing provisions of Article 18 of Regulations 70 (1929 Edition).

Regulations 63 (1922):

ART. 20. *Reservation of income.*—A transfer, not amounting to a bona fide sale for a fair consideration in money or money's worth, is taxable where the decedent reserved to himself during life the income of the property transferred. In such a case the transfer of the principal takes effect in possession and enjoyment at the death of the decedent, and the value of the entire property should be included in the gross estate. Where the decedent reserved a proportionate part of the income, only a corresponding proportion of the value of the property should be included in the gross estate. If, for example, he reserved one-half of the income, the value of one-half of the property transferred should be included in the gross estate. If he reserved an annuity, so much of the property as is necessary to produce the annuity should be included in the gross estate. A transfer is taxable in accordance with these principles whether the decedent reserved the annuity out of the property conveyed, or payment thereof to him was made by the grantee upon an express or an implied agreement to that effect. * * *

Regulations 37 (1921 Edition):

TRANSFERS INTENDED TO TAKE EFFECT AT OR AFTER DEATH

ART. 24. *Reservation of income.*—A transfer is taxable where the grantor reserves to himself during life the income of the property transferred. In such a case the transfer of the principal takes effect in possession and enjoyment after the death of the grantor, and the value of the entire property should be included in the gross estate.

Where the grantor reserves a proportionate part of the income, only a corresponding proportion of the property should be included in the gross estate, unless the transfer was made in contemplation of death. If, for example, he reserves one-half of the income, the value of one-half of the property transferred should be included in the gross estate. If he reserves an annuity, so much of the property as is necessary to produce the annuity should be included in the gross estate. Where the property does not produce income, its value as of the date of the decedent's death should be ascertained, and so much of this sum as is necessary to produce the annuity should be included in the gross estate. A transfer is taxable in accordance with these principles whether the grantor makes a reservation of the annuity out of the property conveyed, or exacts from the grantee an agreement to pay the annuity. * * *

Regulations 37 (1919 Edition), Article 24, contains provisions identical with the foregoing.

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